In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-767

UNITED STATES OF AMERICA, APPELLANT

v.

THE CONNECTICUT NATIONAL BANK, THE FIRST NEW HAVEN NATIONAL BANK, AND JAMES E. SMITH, COMPTROLLER OF THE CURRENCY

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

REPLY BRIEF FOR THE UNITED STATES

1. As we pointed out in our main brief, the Connecticut banking industry is highly concentrated (U.S. Brief, pp. 4–7). The market share for commercial bank deposits of the top five banks was approximately 61 percent in 1971, and the share of the top ten banks in 1971 was over 83 percent. If appellees' merger is consummated, these concentration levels will increase from 61 percent to 65.7 percent (the top five) and from 83.1 percent to 84.9 percent (the top 10) (Computed from App. 1550, 1598).

Appellees do not dispute the fact that Connecticut banking is highly concentrated. Appellees say, how-

ever, that despite these high concentration levels, Connecticut banking is highly competitive.

In support of their contention appellees refer to the recent expansion of certain banks into new territories. While this expansion, which occurred chiefly by *de novo* branching and foothold acquisitions has, within certain local markets, increased banking alternatives and, to this extent, enhanced competition, concentration in local markets persists at high levels (see our U.S. Brief, p. 7). Moreover, benefits from expansion are now threatened by the current efforts of banks among the state's ten largest to combine. If large, healthy banks like Connecticut National and First New Haven are permitted to escape the rigors of expansion by competitive methods and instead to expand by the tempting and profitable merger route, the result will be a state-wide structure in which most local markets will be dominated by a few large banks.[1] Even if appellees' assertion that Connecticut banking is now competitive were accepted as true, there can be no confidence in the continuance of competition if large bank mergers go unchecked. The antitrust laws

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[1] Appellee banks complain that the government is relying upon a theory of state-wide combination—the linked oligolopy theory—which was not presented in the court below. They cite, out of context, a footnote from Solomon, *Bank Merger Policy and Problems: A Linkage Theory of Oligopoly*, 89 Banking Law J. 116 (1972), summarizing in mathematical terms the article's general economic analysis. The government contended throughout the case, however, that there is a serious trend toward concentration in Connecticut and that this threatens the competitive climate in that state.

are concerned not only with present realities but also with future probabilities. Connecticut is now at a crossroads in this respect. If its banking structure becomes even more highly concentrated by the merger of large banks, it will remain so, and healthy competition will be at risk.

The instant merger is not an isolated phenomenon. Appellees' insistence that they must merge to meet the competition of the two largest banks in the state headquartered in Hartford [2] has been echoed by the parties in the merger of Northeast Bancorp. Inc., a holding company for Union Trust, headquartered in New Haven, the state's third largest bank, and First Connecticut Bank Corp., a holding company whose banks in the Hartford area make it the state's ninth largest bank organization. In a closely divided decision (4–3), the Board of Governors of the Federal Reserve System approved this combination on April

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[2] The record does not support the Comptroller's assertion that without approval of this merger there will evolve "* * * a near oligopoly controlled by the Hartford banks" (Comp. Br. at p. 68). The Hartford banks, though the largest in the state, have in fact enjoyed increases and suffered decreases in their share of deposits in recent years: for example, between 1970 and 1971 their combined market share decreased (App. 736). And, according to defendants, one of the Hartford banks in 1973 registered a modest decline, while the other registered a modest gain (Brief For Appellees, p. 4, n. 9). Moreover, the record shows that between 1955–1971 the two Hartford banks increased their deposits by only 2.6 percent, while the next six largest banks share increased five times that amount, by 18.8 percent (from 24.6 percent to 37.9 percent) (App. 740–741). Thus the smaller banks can and do compete effectively with the Hartford banks.

4, 1974.[3] The majority's application of reasoning similar to that urged by appellees and adopted by the district court here confirms the government's fears (rejected by the district court) that this merger will have a triggering effect in Connecticut banking.

2. The district court concluded that this merger was procompetitive because it would produce "a more healthy and balanced banking structure of five or six strong and relatively equal competitors" (J.S. App. 64a). Similarly, the Comptroller of the Currency, as intervenor, contends that the level of competition within a state is not to be decided by the free play of the market through the processes of internal expansion or foothold acquisition, but is to be decided upon the basis of regulatory factors alone (Compt. Br. 115–126). In the Comptroller's view, potential competition is totally irrelevant in banking because the Comptroller and other regulatory agencies stand at the gate of the regulatory barrier through which a potential entrant must pass, and because the Comptroller does not limit ~~lawyers~~ mergers as he does new competitors (Comp. Br. 54, n. 23, 115). Relying on *Camp* v. *Pitts*, 411 U.S. 138, the Comptroller suggests that his decisions on *de novo* applications are essentially not reviewable. While *Camp* v. *Pitts* holds that Administrative Procedure Act review of the Comptroller's decisions on *de novo* applications is limited,

[3] *Northeast Bancorp, Inc.*, 39 Fed. Reg. 13199. This development is directly contrary to the district court's endorsement of appellees' expert's testimony that a merger between any of the three largest banks with any bank in the top ten banks was unlikely. (J. S. App. 63a).

the Comptroller is subject to an "arbitrary and capricious" standard, and there is no reason to expect that the Comptroller will depart from his past practice of permitting *de novo* entry in economically attractive Connecticut markets.[4] Indeed, the Comptroller, like the appelleees, contends that Connecticut banking is highly competitive because of *de novo* expansion in local markets (Comp. Br. 9).

Congress enacted Section 7 of the Clayton Act as "a barrier to what Congress saw was a rising tide of economic concentration * * *" *Brown Shoe Co.* v. *United States,* 370 U.S. at 317–318. In *United States* v. *Philadelphia National Bank,* 374 U.S. 321 (*"Philadelphia National Bank"*), this Court focused upon this "intense Congressional concern" (374 U.S. at 362–363) in applying Section 7 to the highly regulated banking industry, and in holding that concentration was the primary index to whether a merger may substantially lessen competition. In the Bank Merger Act of 1966, 80 Stat. 7, 12 U.S.C. 1828(c), Congress undertook a comprehensive re-examination, in the light of concern within the banking industry over the effects of *Philadelphia National Bank,* of whether and how Section 7 should be applied to banking. It incorporated the antitrust standards of Section 7 and of the Sherman Act into the Bank Merger Act, and made them uniformly binding upon both courts and regulators.

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[4] Between 1966 and 1971 the Comtproller approved 78 of 86 de novo branch applications in Connecticut (U.S. Brief 53). Moreover, on July 24, 1973, the Comptroller chartered a new national bank in Fairfield (Br. for Appellees, p. 84).

In *United States* v. *First National City Bank of Houston,* 386 U.S. 361, this Court recognized that in the 1966 Act Congress had provided for continued application of the antitrust laws to bank mergers, subject to a new defense based on the convenience and needs of the community. In *United States* v. *Third National Bank in Nashville,* 390 U.S. 171, 181, the Court held that the phrase "substantially lessen competition," as it had been construed in cases such as *Philadelphia National Bank,* was incorporated into the Bank Merger Act. It then ruled that "[w]e find in the 1966 Act, which adopted precisely that § 7 Clayton Act phrase, as well as the restraint of trade' language of Sherman Act § 1, no intention to adopt 'antitrust standards' for bank cases different from that used generally in the law." *Id.* at 181–182. Thus, the traditional standards for definition of relevant markets and reliance on concentration as the index of presumed anticompetitive effects were endorsed by Congress for application to the banking industry.

The appropriate number of state-wide institutions, therefore, is not to be determined by an administrative or judicial fiat that four or five or six state-wide institutions are sufficient. Rather, Congress intended structure to be determined by the market through the processes of competition, with expansion occurring by the procompetitive means of *de novo* entry and foothold acquisition.

3. Appellees contend that in Connecticut competition between savings banks and commercial banks is of such scope that commercial banking is not a distinct line of commerce in which the competitive effects

of this merger may be tested. We have set forth in our main brief the authorities demonstrating why the "cluster concept" of commercial banking makes it a distinct line of commerce even though, in particular activities there may be direct competition between savings banks and commercial banks. The facts of this record, as developed from evidence by both the government and the defendants, confirmed the application of the "cluster concept" to this case.

The greatest single difference between commercial banks and savings banks in Connecticut lies in the distinctive adjective "commercial". There is obviously some direct competition between commercial banks and savings banks for personal savings accounts, for real estate mortgages and certain types of personal loans. There is almost no significant competition for commercial and industrial business. Even where competition exists it is marked by significant differences between commercial and savings banks.

Savings banks for example, are not significant sources of non-real estate loans. Only 5 percent of their total loans of $5.01 billion are in this category, while commercial banks have 64.1 percent of their total loans of $3.7 billion in non-real estate loans (App. 640, 1793, 1795). On the other hand, 95 percent of savings banks' loans are in the real estate category, while only 39.5 percent of commercial banks' loans are in this category. Savings banks cannot make personal loans greater than $5,000 and they must be repayable on an installment basis (App. 466, 644). Conn. Gen. Stats. Anno. 36–97a. Commercial banks

are not limited in amount or form. They can and do make single payment loans—indeed, 11.1 percent, some $409.2 million of their total loans, are in this category (App. 479–480, 644).

Commercial banks are the primary source of short term loans to businesses, which are used to finance inventory and supply working capital (App. 487, 1072). Savings banks held only $26 million or 0.5 percent of their total loans in this form, while commercial banks held $1.03 billion or 27.8 percent of their total loans in this category (App. 1793, 1795, 2030. Moreover, savings banks, unlike commercial banks do not offer such services as credit card plans, loans for securities purchases, or trust services; nor do they provide investment services, computer and accounting services, letters of credit and other business-oriented financial services—the very services which the district court emphasized in evaluating the merger under the convenience and needs test (J. S. App. 67a–80a).

While both commercial banks and savings banks compete for personal time deposits, this competition is no different from that in the *Philadelphia National Bank* and in *United States* v. *Phillipsburg Nat. Bank*, 399 U.S. 350, where commercial banks also faced competition from other types of savings institutions for such deposits. In those two cases this Court emphasized the "cluster concept" which makes commercial banking distinctive, even though it also recognized the existence of submarkets which might affect competition between commercial banks and other in-

stitutions. The cluster concept is still valid in Connecticut today.

Just as in *Philadelphia Bank*, where habit, custom, personal relationships, and convenience of one-stop banking, discouraged customers from transferring accounts to obtain one-half percent more interest (374 U.S. at 357, n. 34), so in this case the slightly increased interest rate available to savings banks' depositors is not sufficient to induce people to "walk across the street for an additional half of one percent interest" (App. 1021). Indeed, the Executive Vice President of the Savings Bank Association of Connecticut admitted that full service banking is more significant in Connecticut today than in years past (App. 485).[5]

At the present time savings banks cannot accept demand deposits, which is a major aspect of commercial banking. Appellees stress recent legislation in Connecticut which by no later than January 1, 1976, will permit savings banks to offer this service (App. 2555). Although this will increase competition between commercial banks and savings banks, it is subject to significant limitations that will minimize its significance.

First, the new law expressly permits savings banks

[5] Appellees also err in their contention (Br. 53–54) that the government's witness Dr. Murphy has rejected commercial banking as a line of commerce for purposes of economic analysis. Dr. Murphy, specialist in the study of banking markets (App. 112–113), undertook a study of banking in Connecticut in the light of criteria he had outlined in his previous writings and concluded that commercial banking in Connecticut is a distinctive activity (App. 116–121).

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to offer checking accounts only for personal use (App. 2556). This will exclude business and commercial accounts, which are the particular province of commercial banks. Further, the extent to which savings banks will succeed in promoting this new activity is speculative.[8] Savings bank checks presently do not clear through commercial bank clearing houses or the Federal Reserve System, and hence may be a less attractive form of demand deposit than commercial bank checking accounts. Even assuming that savings institutions vigorously promote this new business, it will be confined to personal accounts and will be subject to the limitations which restrict savings banks. Commercial banks will continue in Connecticut their unique role with respect to financial services, including the offer of commercial and industrial loans, and checking accounts for individuals, partnerships and corporations engaged in business.

4. According to appellees, there are no banking markets in Connecticut which are relevant markets for purposes of section 7. In view of the holding of this Court that identification of local banking markets is the starting point for the analysis of the competitive impact of a bank merger (*Philadelphia National Bank, supra*, 374 U.S. at 357–362), this omission is critical. The defendants, though devoting detailed discussion to individual towns, admit that they are not banking markets (Brief For Appellees 45). They

[8] As we noted in our main brief, experience in states presently permitting savings banks to offer checking accounts suggests that savings banks do not in fact offer significant competition for demand deposits (U.S. Brief, 26, n. 34).

reject the government's argument that metropolitan areas—the major towns and their suburbs—are markets (*id.* at 29–43). While they endorse the district court's determination that the State of Connecticut is the only banking market (Brief For Appellees 44–45; J. S. App. 89a, 92a), they simultaneously contest the relevance of that market to their merger by arguing that they are not engaged in direct competition with each other, but instead compete in "local markets" whose existence they deny (Brief For Appellees 44–45).

We have explained in our main brief why the Bridgeport and New Haven metropolitan areas, or SMSA's, are banking markets and why the district court erred in rejecting that position in favor of the whole State (Brief For the United States, pp. 34–43).[7] If, however, the district court correctly determined that the State is the only relevant section of the country, then this merger must be tested by the well-established principles that govern the merger of actual competitors. This is so not just because the district court found that both defendants are in the same market, but also because the district court found that the de-

[7] The government does not contend that SMSA's are *ipso facto* banking markets. In the Bridgeport and New Haven metropolitan areas, however, the concept of the metropolitan area proves a very useful tool for banking market analysis. As the government's expert on banking, Dr. Murphy, testified on these SMSA's as banking markets: "It's the best we can do" (App. 130). Since banking markets often vary from state to state, the fact that in other cases larger and different metropolitan areas have not proven acceptable as banking markets proves not any inconsistency by the government but only that varying economic circumstances produce varying results.

fendants and other large banks in that market "* * * *act* as though they are competing * * *" (J.S. App. 21a) (emphasis in original).

Thus, as the defendants' expert, Dr. Stokes, testified, the merger will eliminate actual competition, and the measure of the competitive impact in the statewide market is the combination of the defendants' shares of that market: 6.6 percent and 4.7 percent (App. 633). Even after these figures are "shaded" to account for the deposits of Connecticut residents in New York banks, the merged bank will still control more than 10 percent of the market.[8] This Court has held violative of Section 7 mergers which produced a smaller share of a less concentrated market. *United States* v. *Von's Grocery Co.*, 384 U.S. 270; *United States* v. *Pabst Brewing Co.*, 384 U.S. 546.

5. Appellees' arguments that the merger has no effect on potential competition (Brief For Appellees 71–86) are unpersuasive. To begin with, this is a mutual potential competition case: that is, the merger violates Section 7 if it eliminates either Connecticut National Bank as a significant potential competitor in the New Haven market, or First New Haven as a significant potential competitor in the Bridgeport market. As set forth in our main brief, we submit that the merger does both.

Each market is economically attractive, and offers the incentive for entry. Appellees' allegation of the

[8] The district court concluded that a reduction of the combined share by 10 percent was not unreasonable (J.S. App. 42a): so reduced, the statewide market share of the merged banks is 10.2 percent.

supposed economic weakness of the city of Bridgeport (Brief for Appellees, p. 81) misses the point. The Bridgeport metropolitan area, which is the relevant market, has shown good growth in the past and has solid prospects for the future. Each bank has the financial capacity to enter the other's prime market in a competitively significant manner—either by de novo branching or by toe-hold acquisition.[9] Both banks used these techniques of independent expansion when their resources and profits were smaller than they are today (App. 1555–1556; 1561–1562; 1837; 1884). Both techniques are useful now. In these markets there are towns (including Bridgeport) with banks suitable for toe-hold acquisition,[10] and towns open to branching. To be sure, Bridgeport and New Haven cities are closed to branching, but so also is Hartford, yet defendants assert that "[o]ne of the objectives of the proposed merger is to enable appellees to enter

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[9] A modest entry may still be competitively significant; Hartford National entered the Bridgeport market by establishing a branch in Fairfield: it is from this one office that Hartford National has competed vigorously in the Bridgeport market (App. 1952).

[10] Defendants' assertion that the private banker, James Staples & Co. of Bridgeport, is "ineligible for acquisition" (Brief For Appellees 82) is wrong. Staples, a corporation since 1971 (not a partnership as contended by defendants) could be acquired by First New Haven as could a state bank: all that would be necessary would be its prior conversion to a state bank, as provided for in Conn. Gen. Stat. Ann., § 36–171a. In fact, the Charter Oak Bank & Trust Co. of Hartford (App. 1510) is the product of a conversion of a private bank in 1960. See Polk's *World Bank Directory* (March, 1961), Connecticut, p. 12.

Hartford to challenge these banks [Connecticut Bank & Trust and Hartford National Bank] in their headquarters city" (Brief For Appellees 13–14).

6. Appellees contend they could not effectively enter the New Haven or Bridgeport metropolitan areas by foothold acquisition, by *de novo* branching into the suburbs or by use of the holding company procedure. Their arguments are identical to the contentions advanced by Connecticut National and Connecticut Bank and Trust (CBT) to the Comptroller of the Currency when those banks argued that they should be permitted to merge. They contended that home office protection and other barriers barred effective new entry into any major metropolitan market in Connecticut (App. 1919). But when their merger was frustrated by a government antitrust suit, CBT entered Fairfield County *de novo* (App. 507–508). Moreover, because of the exodus of business and industry, as well as residents, from the center cities to the suburbs around New Haven and Bridgeport—suburbs which are within a relatively close radius from the center city—entry there is not only more attractive but is of even greater competitive significance. Foothold banks are available in the New Haven suburbs, as we have shown, and in Bridgeport itself.

The holding company route is also feasible. This was recognized by two of First New Haven's vice presidents (App. 1648) and the holding company process was actually started, but later abandoned, by the Second National Bank of New Haven (App. 1368). It has been used successfully in other states (App. 145–146, 1585, 690, 691, 1357, 1358, and the Comp-

troller has issued new charters under it. (App. 1203–1204, 1980). Cost is not a barrier to use of this procedure for banks as large as First New Haven and Connecticut National. While chartering of a new bank requires a statutory minimum amount of capital of approximately $1.5 million (App. 992), this does not represent the actual out-of-pocket expense. The basic start-up capital would represent only a book transfer of assets from the holding company's lead bank to its new subsidiary. The out-of-pocket expense to be incurred in obtaining facilities would be affected by whether the facilities are built or leased. Leasing reduces capital requirements and is preferred for this reason by another expanding institution in the New Haven area, Union Trust (App. 1161).[11] Thus, the holding company route would cost far less than the $3 million Connecticut National spent remodeling its headquarters (App. 990–993).[12]

CONCLUSION

For the reasons stated in our main brief and in this reply brief, the judgment of the district court should be reversed.

Respectfully submitted.

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Solicitor General.

APRIL 1974.

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[11] Connecticut National leases slightly less than half its branch locations; First New Haven leases about 40 percent (App. 957; 1055).

[12] A holding company subsidiary bank chartered at $1.5 million could invest up to $750,000 in land and buildings (App. 996)—enough for three branches at $250,000 each.

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